

## Message Text

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ACTION EB-07

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E.O. 11652: N/A  
TAGS: EAIR, EIND, CA  
SUBJECT: AEROSPACE INDUSTRY: CANADAI, THE LEARSTAR JET, AND  
QUEBEC

REF: OTTAWA A-585, NOV. 5, 1976;  
OTTAWA A-555, OCT. 21, 1976;  
OTTAWA 4353

1. BEGIN SUMMARY: FINANCIAL, DESIGN, MANAGEMENT AND OTHER CONCERNS ARE PERCOLATING IN THE GOC'S DEPARTMENT OF INDUSTRY, TRADE AND COMMERCE (ITC) REGARDING THE DECISION TO BACK CANADAI'S ENTRY INTO THE BUSINESS JET FIELD. THE OUTCOME OF THESE RUMINATIONS IS NOT CLEAR. POLITICAL SITUATION IN QUEBEC ADDS COMPLICATING FACTOR TO CONSIDERATION OF THIS ISSUE AS WELL AS FUTURE OF CANADIAN AEROSPACE INDUSTRY IN GENERAL. END SUMMARY.

2. ITC MAY BE HAVING SECOND THOUGHTS ABOUT THE WISDOM OF THE GOC DECISION TO BACK CANADAI'S ENTRY INTO THE BUSINESS JET FIELD THROUGH PRODUCTION OF THE LEARSTAR 600. A SENIOR ITC OFFICIAL HAS PRIVATELY TOLD TCO HE IS WORRIED FOR THE FOLLOWING REASONS:

(A) ALTHOUGH THERE ARE SOME FIFTY FIRM ORDERS (BACKED BY LIMITED OFFICIAL USE

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DEPOSITS), HALF OF THEM ARE FROM FEDERAL EXPRESS INC. FEDERAL EXPRESS REQUIRES EXPORT DEVELOPMENT CORPORATION FINANCING, WHICH APPEARS LIKELY BUT IS NOT YET ASSURED.

(B) MORE IMPORTANT IS PROBLEM OF MAINTAINING PRODUCTION SCHEDULE WHICH IS BASED ON SUCCESSFUL TEST FLIGHTS IN EARLY 1978 WITH DELIVERIES COMMENCING IN 1979. CONVERSION OF LEAR'S

BASIC CONCEPT TO A WIDE BODIED ONE REQUIRES LARGE NUMBER OF DESIGN CHANGES AND IT WILL NOT BE KNOWN UNTIL AFTER INITIAL TEST FLIGHTS HOW STABLE THE LEARSTAR'S FLIGHT PERFORMANCE WILL BE AND WHETHER FURTHER DESIGN CHANGES (E.G., A HIGHER TAIL) WILL BE NECESSARY. IF CERTIFICATION IS DELAYED, THE MARKET MAY APPEAR LESS PROMISING IN VIEW OF OTHER BUSINESS JETS ON THE HORIZON.

(C) CONCERN IS SURFACING ABOUT CANADAIR'S GENERAL MANAGEMENT SYSTEM AND ITS ABILITY TO BRING THE PROJECT TO FRUITION, INCLUDING AFTER SALES SERVICE. ITC HAS APPARENTLY JUST REALIZED THAT MARKETING BUSINESS JETS IS NOT QUITE THE SAME AS SELLING TO AIRLINES WHERE A TRADITION OF CARRIER-MANUFACTURER COOPERATION EXISTS TO IRON OUT BUGS AFTER DELIVERY. AS HAPPENED RECENTLY WITH FORD MOTOR COMPANY'S PURCHASE OF SABRELINER JETS, SOURCE OBSERVED, THE MANUFACTURER MUST EXPECT TO HAVE THE AIRCRAFT REFUSED OR RETURNED IF THEY DO NOT WORK PROPERLY ON THE FIRST GO AROUND. THE GOC IS THUS CONSIDERING ON A CONTINGENCY BASIS WHETHER MANAGEMENT CAN BE STRENGTHENED, AND WHAT ADDITIONAL FINANCIAL RESOURCES MAY BE NEEDED BEYOND THE GUARANTEED BANK LOANS ALREADY AVAILABLE (E.G., DIRECT GOC LOANS, INCREASED GOC EQUITY, ETC.).

(D) FINALLY, THERE IS THE POSSIBILITY OF GRUMMAN OR OTHER COMPETITORS REQUESTING APPLICATION OF COUNTERVAILING DUTIES ON IMPORTS INTO THE U.S. WHICH SHOULD BE THE LEADING MARKET FOR THE AIRCRAFT. SOURCE NOTED THAT PREFERENTIAL INTEREST RATE INVOLVED IN THE BANKS' LOAN MIGHT BE CONSIDERED AN ELEMENT OF SUBSIDY. (TCO POINTED OUT THAT INCREASED GOVERNMENT DIRECT FINANCIAL INVOLVEMENT INTENDED TO UNDERPIN THE PRODUCTION EFFORT MIGHT ALSO BE VIEWED AS SUBSIDY.)

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3. COMMENT: THE OUTCOME OF THESE SECOND THOUGHTS IS NOT EASY TO ASSESS. THE GOC HAS COMMITTED ITSELF TO CANADAIR'S LEARSTAR PROJECT LARGELY WITHIN THE FRAMEWORK PROPOSED BY THE COMPANY'S MANAGEMENT AND WITH CONSIDERABLE POLITICAL FANFARE. FURTHERMORE, CANADAIR'S ONLY PLANT--WHERE THE PLANE WOULD BE BUILT--IS IN MONTREAL WHERE THE GOC HAS BEEN ANXIOUS TO MAINTAIN AND INCREASE HIGH TECHNOLOGICAL EMPLOYMENT. VICTORY OF SEPARATIST PARTI QUEBECOIS IN NOVEMBER 15 ELECTION HAS ADDED A COMPLICATING FACTOR TO ANY CONSIDERATION OF CHANGE IN APPROACH. SHORT OF A MAJOR COLLAPSE IN THE MARKET FOR BUSINESS JETS OF THIS TYPE IT IS DOUBTFUL IF THE GOC WOULD VOLUNTARILY WITHDRAW FROM THE PROJECT; BUT, SHOULD NEW DOSES OF CAPITAL BE IN FACT REQUIRED, ANY RELUCTANCE TO COMMIT THEM COULD LEAD TO SIGNIFICANT PRODUCTION AND DELIVERY DIFFICULTIES.

4. THE HEAVY GOC INVOLVEMENT IN THE DECISION PROCESS ATTENDING THE LEARSTAR COMMITMENT HAS ALSO ERODED THE GOVERNMENT'S EFFORTS TO FACE THE QUESTION OF THE LONGER RUN FUTURE OF CANADAIR

AND OF DE HAVILLAND, BOTH OF WHICH ARE STILL SUPPOSED ULTIMATELY TO BE TURNED OVER TO PRIVATE INVESTORS. GIVEN THE POLITICAL SITUATION IN QUEBEC THE OPTION OF CORPORATE INTEGRATION WITH TORONTO-BASED DE HAVILLAND MAY NOT BE CONSIDERED FEASIBLE. ONE VARIANT OF THAT OPTION WOULD INVOLVE THE CONSOLIDATION OF ALL PRODUCTION ACTIVITY AT A NEW PLANT NEAR MIRABEL, FINANCED IN LARGE PART BY THE SALE OF THE EXTENSIVE URBAN LAND SURROUNDING BOTH FACTORIES AT PRESENT. THIS WOULD PROBABLY BE ATTRACTIVE TO QUEBEC IF PUSHED, BUT WOULD AROUSE AN OPPOSITE REACTION IN ONTARIO.

5. EMBASSY UNDERSTANDS GOC IS CONSIDERING THE APPOINTMENT OF A HIGH-LEVEL BODY--UNDER AN OUTSTANDING AEROSPACE FIGURE--TO EXAMINE THE POSSIBLE RATIONALIZATION OF THE INDUSTRY AND ADVISE THE GOVERNMENT AS TO ITS FUTURE.  
LEARY

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